

**DEPARTMENT OF STATE REVENUE**  
**LETTER OF FINDINGS NUMBER: 04-0006**  
**Corporate Income Tax**  
**Tax Period 2000-2002**

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**ISSUE**

**I. Gross Income Tax-Imposition**

**Authority:** IC 6-8.1-5-1(b), IC 6-2.1-2-2, IC 6-2.1-2-1(c)(1)(A), IC 6-2.1-1-8, 45 IAC 1.1-1-11, Indiana Department of State Revenue v. Boswell Oil Co., 148 Ind. App. 569, 268 N.E.2d 303 (1971).

The taxpayer protests the imposition of gross income tax.

**Statement of Facts**

The taxpayer is a purchasing cooperative for hardware and building materials. The taxpayer filed an amended gross income tax return for the year ending June 30, 2000. With this amended return, the taxpayer requested a refund which the Indiana Department of Revenue, "department," issued. The department then audited the taxpayer for the years ending June 30, 2000, through June 30, 2002. As a result of the audit, the department recaptured the refund and assessed additional tax for the years of the audit. The taxpayer protested this assessment. A hearing was held and this Letter of Findings results.

**I. Gross Income Tax-Imposition**

**Discussion**

Originally the taxpayer reported and paid gross income tax at the low rate on all of its transactions. In some of the wholesale sales, the taxpayer alleged that it actually acted as a broker negotiating sales between suppliers and members. In those sales, members place orders directly with the suppliers or with the taxpayer. In both of these situations, the taxpayer has pre-negotiated the price. The orders are drop shipped directly from suppliers to members. The suppliers invoice the taxpayer for the goods allowing discounts for early payment. The taxpayer invoices the members the same amount, the same discount and a variable adder. The amended returns indicated that the variable add-on was a commission subject to gross income tax at the high rate. The department assessed gross income tax on

the gross receipts from the transactions as wholesale sales taxable at the low rate. The taxpayer protested this assessment.

The taxpayer classifies its sales into three categories. First is the classification where it purchases hardware supplies, stores them in its warehouse and sells them to cooperative members. The taxpayer agrees that these transactions are wholesale sales with the gross receipts subject to gross income tax at the low rate.

In the second type of transaction, the member places an order directly with one of the taxpayer's suppliers at prices pre-negotiated by the taxpayer. The suppliers ship the goods directly to the purchasers. The suppliers invoice the taxpayer for the purchases. The taxpayer then invoices the member at the pre-agreed price. Some suppliers pay the taxpayer a commission for arranging the sale, and members are invoiced at the same price that suppliers invoice the taxpayer. Other supplier agreements require the taxpayer to collect some or all of its commission from the purchasing member as an add-on to the price that the taxpayer charges the member. The taxpayer is only entitled to keep the add-on or commission. In all cases, the member and supplier have knowledge of the pricing arrangement.

The third method is for the member to notify the taxpayer that it wishes to purchase a certain amount of a particular product for delivery within a specified time period. The taxpayer purchasing agents shop the contract with qualified suppliers. When the contract terms are settled, the order is placed by the taxpayer on behalf of the member. The supplier invoices the taxpayer and the taxpayer invoices the member. The taxpayer may collect commissions from the supplier and/or the member, as in the second method. This method is used mostly for purchasing commodity products, such as dimensional lumber, that fluctuate in price too much to make the pre-negotiated pricing of the second method practical.

Indiana Department of Revenue assessments are prima facie evidence that the department's claim for unpaid taxes is valid. IC 6-8.1-5-1(b). The taxpayer has the burden of proving whether the department incorrectly imposed the assessment. Id.

IC 6-2.1-2-2 provides:

(a) An income tax, known as the gross income tax, is imposed upon the receipt of:

(1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and

The department and taxpayer are in agreement that the taxpayer is subject to the gross income tax on the receipts from each of the three types of transactions. They disagree, however, on what constitutes the taxable gross income in the second and third types of transactions. The department considered the disputed sales as wholesale sales with the total receipts taxable at the low rate. The taxpayer contended that these transactions were not wholesale sales. Rather, the taxpayer argued that it actually acted as a broker in the last two

types of transactions. As such, only the add on fees or commissions would be subject to the gross income tax. These receipts would be taxed at the high rate.

The issue to be determined in this case is whether the taxpayer is acting as a wholesaler or a broker in the last two scenarios.

The statute defines a “wholesale sale” at IC 6-2.1-2-1(c)(1)(A) as follows:

(A) Sales of tangible personal property (except capital assets or depreciable assets of the seller) for resale in the form in which it was purchased.

The income of brokers subject to the Indiana gross income tax is delineated at IC 6-2.1-1-8 as follows:

In the case of banks, national banks, trust companies, building and loan associations, investment companies regulated under the Federal Investment Company Act of 1940, as amended and in effect on January 1, 1977, brokers, dealers in securities, finance companies, dealers in commercial paper, and taxpayers engaged in the business of lending money or providing credit “gross income” means gross earning with respect to the businesses and activities enumerated in this section.

The Indiana Court of Appeals dealt with this issue in Indiana Department of State Revenue v. Boswell Oil Co., 148 Ind. App. 569, 268 N.E.2d 303 (1971). In that case, the department assessed Boswell as a wholesaler of fuel oil. Boswell argued that it was a broker or middleman who matched sellers with buyers. It contracted separately with the suppliers and purchasers in its own name. Boswell never took possession of the fuel oil or had any interest in it. Rather, Boswell arranged for the fuel oil to be shipped from the suppliers directly to the purchasers. Boswell collected payment from the purchasers. It paid the suppliers directly and kept a service fee or commission for itself. The court found that, based upon its method of conducting business, Boswell met the definition of a “broker.” Therefore it was entitled to use the statutory gross earnings method and pay the gross income tax at the high rate on its commissions.

In considering the gross income tax liability of Boswell, the court described the situation as follows:

As we see it, Boswell meets [the] definition [of a broker] in that . . . it matches suppliers of residual fuel oil and consumers of such oil, negotiates fuel prices, causes the fuel oil to be transported directly from the refinery to the consumer, maintains no store of oil in Indiana for sale or investment, and the refiner and the consumer each know to whom the oil is sold and shipped. So far, Boswell has negotiated a “contract” between others and has dealt with contracting parties and has no interest

in nor possession of the property. Thus, Boswell has performed the essential function of a broker, which is to negotiate contracts between others, and, unlike a factor, has not taken possession, management, or control of the goods.

268 N.E.2d at 306.

The department's regulations reflect the Court's determination in the Boswell case. 45 IAC 1.1-1-11 provides as follows:

- (a) "Gross income of a broker" means the commissions earned from brokerage transactions without any deductions of any kind or character.
- (b) As used in this section, "broker" includes a securities broker and a commodity broker. However, it does not include a taxpayer who purchases produce or otherwise acquires the ownership of a stock of commodities carried and handled for sale in its normal trade or business. The essential function of a broker is making a bargain for contracting parties without taking possession, management, control, or title of the goods involved. A broker cannot make a contract in its own name, except under the following circumstances:
  - (1) The contract is made with the knowledge and consent of the broker's principal.
  - (2) The contract is justified by the usages of trade of the particular business involved.
- (c) As used in this section, "brokerage transaction" means a group of activities whereby a taxpayer is paid a commission for bringing a buyer and seller together and completing a sale of property.
- (d) A taxpayer acting as a broker for goods and, at the same time, as a retail merchant for the same or similar type of goods, will report its gross income under subsection (a) only to the extent that its income is received from acting as a broker.

The taxpayer only meets the statutory qualifications of being a wholesaler by purchasing materials and reselling them in the same form in the first type of transaction. Therefore, that is the only instance of a wholesale sale with the all receipts being subject to the gross income tax at the low rate.

In the second and third types of transactions, the taxpayer does not take possession or title to the goods. Since the taxpayer does not take possession or title to the goods, it does not resell them. Rather, the taxpayer brings buyers and sellers together to assist in the completion of a sale. The product is shipped directly from the supplier to the buyer. The suppliers and purchasers know each other's identities and the identity of the broker. These transactions are analogous to the brokerage transactions in the Boswell case. The second and third methods of taxpayer's operations also meet the statutory and regulatory conditions for the

taxpayer to be treated as a broker. Therefore, only the taxpayer's commissions or brokerage fees are subject to the Indiana gross income tax at the high rate.

**Finding**

The taxpayer's protest is sustained.

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